

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2011-017443

05/21/2012

HONORABLE JOHN A. BUTTRICK

CLERK OF THE COURT

C. Castro

Deputy

KENNETH FIELDS, et al.

COLIN F CAMPBELL

v.

ELECTED OFFICIAL RETIREMENT PLAN OF THE STATE OF ARIZONA, THE, et al. BENNETT EVAN COOPER

CHARLES A GRUBE

UNDER ADVISEMENT RULING

Courtroom 704 - Central Court Building.

1:46 p.m. This is the time set for closing arguments. Plaintiff Kenneth Fields is present with counsel, Colin F. Campbell and Sharad Desai. Defendant The Elected Officials' Retirement Plan of The State of Arizona is represented by counsel, Bennett Evan Cooper, and Shannon Trebbe. Intervenor/Defendant State of Arizona is represented by counsel, Charles A. Grube.

A record of the proceedings is made by audio and/or videotape in lieu of a court reporter.

A clarification is made on the record regarding exhibits in this case.

The record shall reflect Defendants' Exhibit 37 was previously stipulated into evidence on April 10, 2012.

Defendants' Exhibits 25 through 36 are received in evidence.

Closing arguments are presented.

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IT IS ORDERED taking this matter under advisement.

4:08 p.m. Matter concludes.

LATER:

The Plaintiffs in this class action are composed of: (a) all retired members of the Elected Officials' Retirement Plan ("EORP") as of the effective date of Senate Bill 1609 ("SB 1609"), or those who applied for EORP benefits and were found eligible for benefits as of the effective date of SB 1609; and (b) all spouses, widows or widowers, and children 23 years of age or younger of these retired members and applicants.

The Defendants are EORP, the Trustees of EORP in their official capacities and the Intervenor, State of Arizona.

Pursuant to Ariz. R. Civ. P. 65 (a) (2) the hearing on Plaintiffs' Motion for Preliminary Injunction and trial to the Court on the merits were held in combination on April 10, 2012. Closing arguments were conducted on May 21, 2012 and the matter was taken under advisement at that time.

Plaintiffs seek declaratory, injunctive and mandamus relief as set forth in the Second Amended Complaint, filed October 6, 2011.

FINDINGS OF FACT

EORP was established by the Arizona legislature in 1985 as a pension fund serving elected officials, judges and plan administrators upon their completion of a set number of years of service, as well as certain of their survivors. *See* A.R.S. §§ 38-801 (15), 38-802, 38-805.

Members of EORP who retired or applied for retirement benefits before the enactment of SB 1609 may, upon retirement, received yearly payments totaling up to 80% of their pre-retirement salaries depending upon their pre-retirement years of credited service. *See* A.R.S. §§ 38-808 (B) (1).

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In addition, at the time Plaintiffs were fully vested in their retirement benefits, the EORP provided for additional financial benefits in the form of medical payment subsidies (A.R.S. § 38-817), permanent benefit increases (A.R.S. § 38-818), and spousal survivor benefits (A.R.S. § 38-806).

EORP is funded from a combination of employer contributions, employee contributions, judicial fees, and investment proceeds from the plan.

The amount of employer contributions needed to fund EORP is calculated based upon actuarial projections of projected payouts to beneficiaries and estimated income from market returns. *See* A.R.S. § 38-810 (C). The employer contribution is set each year by EORP's actuary, and the amount of the employer contribution is set at an amount necessary to fully fund EORP's obligations over the actuarial assumed thirty year life of EORP. When EORP is less than 100% funded, the employer contribution amount includes an amount to cover unfunded liabilities. Employers under EORP include the State of Arizona, the Counties and certain municipal governments.

The legislature enacted the first statutory mechanism for base benefit increases to EORP's beneficiaries in 1990. *See* A.R.S. § 38-818 (1990); 1990 Ariz. Sess. Laws, ch. 236, § 4.

In 1996, the legislature enacted a new statutory formula for permanent increases in base benefits under which the maximum benefit increase was the lesser of 3% or half of the percentage change of the Consumer Price Index for All Urban Consumers ("CPI-U"). A.R.S. § 38-818(A), (B), (F) (1996); 1996 Ariz. Sess. Laws, ch. 198, §§ 2, 3.

In 1998, the legislature amended the 1996 formula and established a new formula that provided a maximum annual benefit increase of 4% and eliminated the connection between increases and the CPI-U. A.R.S. § 38- 818 (F) (1998); 1998 Ariz. Sess. Laws ch. 264, § 1.

Under the 1998 formula, the amount of the permanent base benefit increase is determined by applying A.R.S. § 38-818 (B), which states that the increase may be between zero and 4%, and generally requires the benefit increase to be fully actuarially funded, with a present value cost calculation, at the time it is granted. Base benefit increases are contingent upon the funds investment earnings. If the funds earnings exceed 9%, half of the amount by which investments earnings exceed 9% (the "Hurdle Rate") are used to fund base benefit increases. Those excess earnings are placed in a Reserve if they were not used for permanent base benefit increases. A.R.S. § 38-818 (C) (E) (1998).

Pursuant to the 1998 formula, EORP beneficiaries received annual permanent base benefit increases of 4% from fiscal years 1998 to 2010.

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SB 1609 passed the Arizona House and the Arizona Senate and was signed into law by the Governor on April 29, 2011.

Although SB 1609 became effective on July 20, 2011, it applied retroactively to May 31, 2011 to eliminate the transfer of excess earnings above the 9% Hurdle Rate to the Reserve for future permanent base benefit increases. SB 1609 allowed the funds remaining in the Reserve as of May 31, 2011 to be used to fund permanent base benefit increases under A.R.S. § 38-818 until the Reserve was depleted. *See* A.R.S. § 38-818.01(G). Effective July 1, 2013, SB 1609 increased the Hurdle Rate from 9% to 10.5%. *See* A.R.S. § 38-818.01(D).

Effective July 1, 2013, SB 1609 linked the amount of the permanent base benefit increase in a given year to the funding ratio of EORP at the time of the increase. The amount of the permanent base benefit increase grows as the funding ratio increases: if the funding ratio is 60% or less, EORP will not fund permanent benefit increases, if the funding ratio is between 60% and 65%, EORP will fund a permanent base benefit increase of 2%, and for each 5% increase in the funding ratio above 65%, EORP will increase the amount of the permanent base benefit increase by 0.5%, with a maximum permanent base benefit increase of 4%. A.R.S. § 38-818.01(A), (C). Effective July 1, 2013, under SB 1609 all excess returns above 10.5% that are not used to fund a permanent base benefit increase must be returned to EORP's general fund. A.R.S. § 38-818.01(E). Under SB 1609, retirees are eligible to receive ad hoc permanent base benefit increases from the legislature beginning in 2015. A.R.S. § 38-818.02. SB 1609, EORP beneficiaries' rights under the permanent base benefit increase provision had never been impaired or diminished by the legislature.

Historically, A.R.S. § 38-818 has provided annual permanent benefit increases in financial benefits to Plaintiffs since its enactment in 1996. Since 1998, the scheme, including the Reserve, has provided for the complete actuarial funding of these permanent increases on a present value basis each year as to the Plaintiffs in the amount of 4%. These benefit increases were fully funded by present value calculations at the time they were given. Plaintiffs have received permanent 4% increases in their pension benefit every year since 1998 until the passage of SB 1609. These benefit increases resulted in actual financial benefits paid to Plaintiffs.

As of July 1, 2011, the Reserve received \$31,000,000 in excess earnings from EORP plan investments for fiscal Plan year 2011. As of July 1, 2011, the reserve was sufficient to fund a 4% permanent benefit increase to Plaintiffs. Under the law existing as of July 1, 2011, the EORP should have declared a permanent benefit increase for its retirees of 4%. On July 21, 2011, by reason of SB 1609's retroactive elimination of the transfer of funds to the Reserve to May 2011, Plaintiffs had their 2011 benefit increase reduced from 4% to 2.47%.

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If SB 1609 had not been enacted, the Reserve would have had approximately \$26,000,000 remaining after payment of a 4% benefit increase in 2011. The Reserve would have also had sufficient funding to provide for a permanent benefit increase on July 1, 2012. By reason of the enactment of SB 1609, Plaintiffs will not receive any permanent benefit increase on or about July 1, 2012.

The purpose and effect of SB 1609 is to impair and diminish the permanent benefit increases provided by A.R.S. § 38-818 to Plaintiffs. It retroactively eliminated the Reserve and diminished the permanent benefit increase from 4% to 2.47% as of July 1, 2011. It denied any permanent benefit increase as of July 1, 2012, by eliminating the Reserve entirely, and by not providing for any permanent benefit increase at all in EORP plan year 2012. It also impairs and diminishes future benefits after July 1, 2013. Under SB 1609, permanent increases will be given infrequently, and, even then, in lesser amounts. Because excess reserves are not earned every year, it is certain that no benefit increase will occur in those future years. The obvious purpose of SB 1609 is to slow down benefit increases, make them less frequent, and make them less than 4%.

CONCLUSIONS OF LAW

Article XXIX, § 1(c), of the Arizona Constitution states that “[m]embership in a public retirement system is a contractual relationship that is subject to article II, § 25, and public retirement benefits shall not be diminished or impaired.” [Emphasis added.] The permanent base benefit increase provided by A.R.S. § 38-818 – specifically, the 1998 formula – is an actual financial “benefit” to Plaintiffs. A.R.S. § 38-818(A) specifically states: “Effective July 1 of each year, each retired member or survivor of a retired member is **entitled** to receive a permanent increase in the base benefit equal to the amount determined pursuant to this section” [Emphasis added.] The 1998 formula is a “benefit” as that term is used in Article XXIX, § 1(c).

A retired EORP member (or survivor) is entitled to this benefit so long as he or she satisfies one of two conditions set forth in A.R.S. § 38-818(A): (1) the member must have been receiving benefits on or before July 31 of the two previous years; or (2) the member must be 55 years of age or older on July 1 of the current year and was receiving benefits on or before July 31 of the previous year. If either one of these two conditions are met, the retired member is “**entitled**” to a permanent base benefit increase as calculated under the provisions of § 38-818.

There is nothing more that Plaintiffs have to do to earn their pension benefits. They have retired; they have fully performed every condition for a benefit. In determining what benefits Plaintiffs are vested in on the day they retired, A.R.S. § 38-810.02(A) states: “the legislature intends that the plan as enacted at a particular time be construed and applied as a coherent whole

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and without reference to any other provision of the plan in effect at a different time.” Under this statute, the benefits that Plaintiffs are vested in are plainly the benefits in effect at the time of their retirement.¹

SB1609 violates the express mandate of Article XXIX, §1(c), of the Arizona Constitution that “public retirement benefits shall not be diminished or impaired.” No fair reading of the Constitution yields any other conclusion when the obvious effect of SB1609 is considered. The retirement benefits of the Plaintiff class have been and will be directly adversely impacted by SB1609. This is precisely the sort of result intended to be barred by the cited Constitutional provision.²

The declaratory relief sought by Plaintiffs in Count One of the Second Amended Complaint is hereby granted.³

Plaintiffs shall lodge a form of Judgment consistent with this ruling.

FILED: Exhibit Worksheet; Trial/Hearing Worksheet

Dated: May 25, 2012

/ s / HONORABLE JOHN A. BUTTRICK

JUDICIAL OFFICER OF THE SUPERIOR COURT

¹ Whether the retirement benefits at issue here vested before retirement is not necessary to be decided. All class members in this case retired before SB1609 was enacted.

² Defendants’ argument that the permanent base benefit increase does not constitute a “benefit” runs counter to common sense, common usage and the plain meaning of the language of §1(c). It is unsupported by any controlling authority.

³ The Court need not and does not reach the issue whether SB1609 violates the State or Federal Contract Impairment Clauses.